APR 25 1974

MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

April Term, 1974

No. 73-1602

TIDE OIL COMPANY,
Petitioner,

v.

CHARLES W. WOLVERTON and
WOLVERTON OIL COMPANY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ARTHUR P. KEARNEY
Counsel for Petitioner

Office and Post Office Address:
3737 W. Commodore Way
P.O. Box 99073
Magnolia Station
Seattle, Washington 98199

SUBJECT INDEX

Page

I. Opinions Delivered In Courts Below 1

II. Jurisdictional Statement 2

III. Questions Presented 2

IV. Statutes Involved 2

V. Statement of Case 3

VI. Reasons Relied on for Allowance of Writ 6

1. The Decision of Said Court of Appeals, Sanctioning the Lower Court and Allowing the Bankrupt to Recover *vis-a-vis* a Preferential Transferee Whose Funds Had Previously Been Taken Results In an Equitable Windfall for the Bankrupt and So Far Departs From the Accepted and Usual Course of Judicial Proceedings as to Call for an Exercise of This Court's Power of Supervision 6

2. The Court's Action Below Denying Rehearing After the Death of Judge Hamlin Denied Petitioner the Benefit of Oral Argument to All Judges and Thereby to Due Process of Law 10

VII. Conclusion 13

Appendices:

Appendix A A-1

Appendix B A-14

Appendix C A-16

TABLES OF AUTHORITY

Table of Cases

Doggett v. Emerson,
1 Woodb. & M.I. F. Cas. No. 3,961 (1845) 11

In re Decker, 295 F. Supp. 501 (W.D. Va. 1969) 9

In re Elkins-Dell Manufacturing Co.,
253 F. Supp. 864 (E.D. Pa. 1966) 9

Page

In re Goss, 43 F.2d 746 (N.D. Ga. 1930) 8

In re Gunning 124 F.2d 7 (9th Cir. 1941) 9

Leventhal v. Spillman,
234 F. Supp. 207 (E.D. N.Y. 1964) 9

Nicklaus v. Peoples Bank & Trust Co., Russellville, Ark.,
258 F. Supp. 482 (E.D. Ark. 1965) 9

U.S. v. Garcia,
25 F. Cas. 1242, No. 15,186 (D. Cal. 1870) 12

Wolverton v. Shell Oil Company,
442 F.2d 666 (9th Cir. 1971) 5

Statutes

Title 11 USC (Bankruptcy Act) 3

11 USC § 96 (Bankruptcy Act § 60) 4

11 USC § 96(b) (Bankruptcy Act § 60(b)) 2, 4, 7

28 USC § 1254 2

Textbooks

1 *Collier on Bankruptcy* (14th Ed.) 2.09 9

3 *Collier on Bankruptcy* (14th Ed.) 60.03 7

Cowans, *Bankruptcy Law and Practice* (1963) 745 ff.,
464 ff. 9

6 *Remington on Bankruptcy* (5th Ed. 1952) 2890 7-8

Other Authority

Fed. R. App. P. 40(a) 2, 12

Fed. R. App. P. 43(c) 12

Fed. R. App. P. 43(c)(1) 2, 12

Fed. R. Civ. P. 60(b) 4

IN THE

Supreme Court of the United States

April Term, 1974

No.....

TIME OIL COMPANY,
Petitioner,

v.

CHARLES W. WOLVERTON and
WOLVERTON OIL COMPANY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable Warren Burger, Chief Justice of the Supreme Court of the United States and the Associate Justices of the Supreme Court of the United States:

This is a petition by TIME OIL Co. for a writ of certiorari to review a judgment of the United States Court of Appeals for the Ninth Circuit entered in the above case.

I. OPINIONS DELIVERED IN COURTS BELOW

The opinion of the Court of Appeals for the Ninth Circuit, appears in the Appendix A hereto and in 491 F.2d 361.

II. JURISDICTIONAL STATEMENT

The date of the judgment sought to be reviewed is January 3, 1974, and the time of its entry is January 3, 1974. An order denying a rehearing was entered on March 12, 1974. A stay of mandate was entered on March 25, 1974 staying the mandate of the court to April 25, 1974 for filing of this petition. The statutory provision believed to confer jurisdiction on this court to review the judgment in question is section 1254 of Title 28 of the United States Code.

III. QUESTIONS PRESENTED

The questions presented for review are:

1. In a bankruptcy proceeding, after all creditors are paid, may a creditor previously adjudged a preferential transferee recover from monies existing as a surplus in the bankrupt's estate, an amount equal to the amount of funds taken from it as a result of the preference action?

2. Does the death of a judge, who has voted with the majority on a three judge panel, after he had written an opinion, but prior to either entry or promulgation, invalidate the judgment, further, on such facts does due process require a rehearing in order to permit full benefit of oral argument?

IV. STATUTES INVOLVED

Federal Rules of Appellate Procedure, Rule 40(a) and Federal Rules of Appellate Procedure, Rule 43(c)(1).

Section 60(b) of the Bankruptcy Act, 11 U.S.C.

V. STATEMENT OF CASE

The jurisdiction of the District Court was originally evoked because the question arises under the Federal Bankruptcy Act, Title 11, USC.

The bankrupt, d/b/a Wolverton Oil Company and Wolco, operated a retail gasoline service station in Sunnyvale, California. On February 7, 1964, he was indebted to his supplier, Time Oil Company (Time), Petitioner, for the purchase of petroleum products in the amount of $22,560.33. On that date, the bankrupt assigned and transferred to Time, as security for said indebtedness and consideration for future consignments of gasoline, the following: (1) the leasehold on the above noted Sunnyvale service station, said lease having two years remaining on its original term, plus two renewal options for five years each, (2) the sum of $3,600, which had been deposited with the lessor as prepaid rent, and (3) improvements which the bankrupt had constructed and installed upon the premises covered by the lease.

The value of the leasehold assigned and transferred, including the amount of the prepaid rent, but excluding the value of the improvements, as found by the referee, was the sum of $36,000.00.

In April, 1964, within four months after the assignment and transfer noted above, the bankrupt filed a voluntary Petition in Bankruptcy, and was adjudicated a bankrupt. Subsequent to April, 1964, Time used up the prepaid rent on the property which had been assigned to it to secure the debt owed by the bankrupt and failed to exercise the option to renew the aforementioned lease. In late

1966, Time abandoned the property, returning to the landlord its rights, title and interest therein.

In April, 1966, the trustee brought a preference action against Time for recovery of the property assigned and transferred to it in February, 1964, or its value. After a trial held in July, 1968, the referee found that the assignment and transfer constituted a voidable preference as defined in section 60 of the Bankruptcy Act (hereinafter the Act), 11 U.S.C. § 96. The referee further found that Time had converted the assigned leasehold by failing to exercise the option to renew.

Upon the referee's findings of the voidable preference, it became incumbent upon Time to return the object of the preference, the leasehold, to the bankrupt's estate. Section 60(b) of the Act, 11 U.S.C. § 96(b). However, Time could not return that which it had converted and, in lieu thereof, the referee ordered Time to pay into the bankrupt's estate the leasehold's value, plus interest, a total sum of $45,308.08. The referee had ascertained this exact value largely upon the basis of the value of the five-year renewal option periods.

In March, 1969, the referee entered a judgment awarding the $45,308.08 to the trustee, payable to him by Time.

A Petition for Review was filed by Time from this judgment. The United States District Court for the Northern District of California (Harris, J.) denied the petition, and also denied a concurrently filed Motion for Relief from said judgment under section 60(b) of the Federal Rules of Civil Procedure. No appeal was taken by appellant from these orders and they became final. Thereafter, the

trustee duly recovered from Time the $45,308.08 in payment of the judgment entered by the referee.

Acting for himself, and prior to the issuance of the preference order and judgment, the bankrupt had secured a new lease on the very property it had previously assigned and transferred to Time. The bankrupt took possession of the property in January, 1967, under a new five-year lease, with a five-year renewal option. Apparently, the operation of the service station under this new lease was profitable.

In the meantime, in March, 1965, the bankrupt had purchased from the trustee cause of actions for violations of the antitrust laws by the major oil companies. That sale, however, was consumated without notice to the creditors. The United States District Court for the Northern District of California (Zirpoli, J.) therefore set aside the order confirming said sale, and the Ninth Circuit affirmed. *Wolverton v. Shell Oil Company*, 442 F.2d 666 (9th Cir. 1971). The result was to cast into the bankrupt's estate in excess of $150,000 in settlement proceeds. These funds created a substantial surplus in the bankruptcy estate.

In November, 1971, the referee entered his order directing the trustee to pay in full all properly filed claims, and to distribute a notice of additional time in which to file claims not previously filed.

Time then filed a claim for $45,308.08, the amount of the preference judgment it had been ordered by the referee to pay to the trustee and refiled its claim of $22,560.33.

The original indebtedness owed by the bankrupt to Time, $22,560.33, was paid in full. But the referee, sustain-

ing the trustee's objection, held that Time's sole legitimate claim was limited to this amount, *i.e.*, the amount owed before the preferential transfer, and that Time was not entitled to recover both the amount of said debt and the value of the property given by the bankrupt to secure this indebtedness.

The Ninth Circuit Court of Appeals (opinion appended hereto) affirmed the referee's order sustaining the trustee's objection to Time's proof of claim and the district court's order denying appellant's petition for review.

However, Judge Oliver D. Hamlin voting with the majority died prior to entry of the Ninth Circuit opinion. Judge Hamlin sent the opinion to the clerk with a memorandum dated December 28, 1973. This was the very day of his death. In the memorandum, Judge Hamlin states that Judge Ely concurs, and he tells the clerk that Judge Koelsch will be dissenting. The dissenting opinion did not reach the clerk until January 2 and the opinion was entered on January 3. Time's Petition for rehearing was denied, (Appendix B) Judge Ben C. Dunaway being chosen by lot to act with Judges Koelsch and Ely in connection with the petition for rehearing.

VI. REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. The Decision of Said Court of Appeals, Sanctioning the Lower Court and Allowing the Bankrupt to Recover *vis-a-vis* a Preferential Transferee Whose Funds Had Previously Been Taken Results In an Equitable Windfall for the Bankrupt and So Far Departs From the Accepted and Usual Course of Judicial Proceedings as to Call for an Exercise of This Court's Power of Supervision.

The determination that the bankrupt may keep monies taken from Time in a preference action is not equitable and is erroneous.

The purpose of a preference action is to provide equal treatment among creditors of the same class so that some creditors are not disadvantaged *vis-a-vis* the preferential transferee. See Section 60(b) of the Bankruptcy Act, 11 U.S.C. § 96(b). It is for this reason that the preferential transferee is made to return the preference (or its value). Therefore, the purpose of a preference action is not to enrich the bankrupt or to punish the transferee or to serve as a substitute for an action for conversion.

No odium attaches to a preference. See 3 *Collier on Bankruptcy* (14th ed.) 60.03:

> ". . . a preference may be a perfectly valid and legitimate business transaction . . . There is no element of moral turpitude connected with the giving of a mere preference (as distinguished from a fraudulent transfer)".

The preferential transferee is made to return the preference for the benefit of creditors, although the transferee's only "fault" was knowledge of the bankrupt's insolvency at the time of the transfer, coupled with the fact that the transfer chanced to be within four (4) months of the filing of the bankruptcy.

Principles of equity determine who is entitled to recover from any surplus. The general principles are found in 6 *Remington on Bankruptcy* (5th ed. 1952) 2890:

> "*Disposition of surplus assets.* — Except for a somewhat casual statement in 66(b), there is no provision in the Bankruptcy Act requiring return to the bankrupt of any surplus remaining, should there be one, after full payment of his obligations and the expenses of administration. However, it is well settled, on principles of equity, that he is entitled to any such surplus . . .

> "The bankrupt's right to surplus proceeds being equitable, superior equities have sometimes been recognized, as where he scheduled an obligation for which he was equitably, but not legally, bound, and, because of the nature of the claim, it was proved or established in the bankruptcy proceedings . . . If the surplus has been derived from the setting aside of a fraudulent transfer, ordinarily it will go back to the fraudulent grantee, since the fraudulent grantor put the property there and will not be heard to set up his own fraud; but if the bankrupt made the transfer through the undue influence of the grantee or was otherwise not in pari delicto with him, the surplus will be turned back to the bankrupt or, if he has meanwhile died, to his administrators or heirs (citing *In re Goss*, 43 F. 2d 746 (N.D. Ga. 1930))."

In the *Goss* case, *supra*, cited by *Remington, supra*, the court stated that prima facie the surplus would go to a fraudulent grantee from whom recovery had been effected (rather than to the bankrupt). However, the court sustained an award by the referee to the heirs of the bankrupt because the grantor and the grantee were not in pari delicto. The grantor had been very old and under the grantee's influence, and the grantee had paid nothing for the transfer. Moreover, as the court observed, there were debts arising after the bankruptcy. Apparently the court felt that these debts were entitled to priority over the fraudulent grantee.

There cannot be any suggestion that Wolverton was subjected to any kind of coercion or undue influence. He suggested the assignment. At the time of the bankrupt's assignment of the lease to Time he was represented by counsel.

Time as a preferential transferee should be viewed even more favorably than a fraudulent grantee. A debtor may

prefer one creditor to another. There is no fraudulent transfer unless a *debtor* and a creditor have a fraudulent intent. Additional elements are required to transform an innocent preference into a fraudulent transfer. See Cowans, *Bankruptcy Law and Practice* (1963) 745 ff., preferences, and 754 ff., fraudulent conveyances; *In re Decker,* 295 F. Supp. 501 (W.D. Va. 1969) (fraudulent intent required, intent to prefer not enough), affirmed 420 F.2d 378; *Leventhal v. Spillman,* 234 F. Supp. 207 (E.D.N.Y. 1964); and *Nicklaus v. Peoples Bank & Trust Co., Russellville, Ark.,* 258 F. Supp. 482 (E.D. Ark. 1965). The fraudulent grantee takes without paying adequate consideration and with the proved intent to defraud other creditors. *Decker, supra.*

The bankruptcy court as a court of equity has broad powers to do equity. 1 *Collier on Bankruptcy* (14th ed.) 2.09. For example, a bankruptcy court may adopt a state remedy or do equity more liberally than a state court would, *In re Gunning,* 124 F.2d 7 (9th Cir. 1941), and a claimant's legal right is not controlling, if equity dictates otherwise, *In re Elkins-Dell Manufacturing Company, Inc.,* 253 F. Supp. 864 (E.D. Pa. 1966).

The referee valued the lease assigned to Time at $36,000 principally because it contained two options to renew for five (5) years each. The referee disposed of Time's contention in the preference action that the lease was without value because of a gasoline price war as follows:

> ". . . The gas war was not overlooked in fixing the valuation. With two five-year options remaining, consideration was given to the unlikely prospect that a gas war would continue for great lengths of time."
>
> (Document 17, Tr. 110, 112, opinion on reconsideration.)

Time was charged with not picking up the first option to renew. Therefore, it was not able to return the security and was charged with its entire value. As the referee found:

> "11. Defendant, TIME OIL COMPANY, is unable to return to the Trustee in Bankruptcy the property assigned and transferred to it by the Bankrupt, or any part thereof."
>
> (Document 6, Tr. 124, Finding of Fact 11, Tr. 126.)

Time did not obtain any ten (10) year lease. There cannot be any argument that Time was unjustly enriched. On the other hand, the bankrupt lost nothing since he obtained a new lease on more advantageous terms for a five (5) year initial period plus an option for five (5) years more. Thus, the bankrupt in reality lost nothing through any fault of Time. And Time gained nothing. If the decision below is allowed to stand, the bankrupt will be enabled to keep the $45,000 taken from Time as well as to enjoy his new lease. This result would be inequitable.

Letting the bankrupt keep the $45,000 recovered in the preference action and at the same time allowing him to enjoy his new lease, while depriving Time of the $45,000 to give a windfall to the bankrupt, is *not* doing equity.

2. The Court's Action Below Denying Rehearing After the Death of Judge Hamlin Denied Petitioner the Benefit of Oral Argument to All Judges and Thereby to Due Process of Law

As noted in the statement of the case, Judge Hamlin together with Judge Ely formed the majority in the Ninth Circuit's opinion. Judge Hamlin had formulated the opinion and forwarded it to the clerk with a memorandum dated December 28, 1973, the date of his death. Judgment was not entered until January 3, 1974.

The case of *Doggett v. Emerson,* 1 Woodb. & M.I., F. Cas. No. 3,961 (1845) involved the question of the effect of the death of Justice Joseph Story (also Circuit Judge for the First Circuit). The judge had heard and decided a case in equity and had announced the decision to counsel for the parties and actually corrected a form of decree in the presence of their counsel. The judge died the day after forwarding the papers to the clerk. On motion by the plaintiff to enter and carry into effect the decree of the Circuit Court for the First Circuit did so over objection. The significance of the opinion to Petitioner is that the court attached critical significance to the fact that the decree had been announced to the parties prior to the judge's death:

> "Where a Court has been changed between the formation of an opinion and the delivery of it, or a Judge dies with opinions on file *and never delivered,* and decrees never completed in their details, *nor communicated to the parties* in Court, or at an agreed hearing in vacation, it is admitted that the whole ground fails, that exists here for sustaining and entering up this decree.
>
> "A Court changed is not the same Court. *An opinion, not delivered i.e.* communicated to the parties), or a decree, not drawn up in detail, *may never be uttered or made as proposed.*
>
> But here the opinion was actually delivered, and read to the parties. The decree was framed after a full hearing, and also communicated to them, and then handed to the reporter, in order that it might be, as it afterwards was, transmitted to the clerk of the Court to be properly entered as the act of the Court." (p. 6) (emphasis added)

A federal case twenty-five years later in California discussed the *Doggett* case and summarized its holding as follows:

> ". . . It was held that the intervening death of the judge was no ground for a rehearing if an opinion was actually delivered; but otherwise, if only prepared . . ." *U.S. v. Garcia*, 25 F. Cas. 1242, 1244 F. Cas. No. 15,186 (D. Cal. 1870).

Garcia did not involve the precise point involved here, although the judge who rendered the decision died shortly afterwards. The court decided to re-examine the matter, the question of the sufficiency of entry of a decree being debatable. Until a judgment is entered it is not recognized as final and until an opinion is filed and *judgment* entered it can be changed.

Rule 40(a), Federal Rules of Appellate Procedure provides that oral argument in support of a petition for rehearing will not be permitted, however it does not precisely cover the situation involved here where a substituted judge has not in the first instance received the benefit of oral argument. Similarly, Federal Rules of Appellate Procedure 43(c) provides only for automatic substitution of a public officer. However, Rule 43(c)(1) by implication recognizes that substantial rights of the parties may be effected by death where it states "Proceedings following the substitution shall be in the name of the substituted party, but any misnomer not affecting the substantial rights of the parties shall be disregarded."

This unique situation denying the same rights as afforded others similarly situated caused by the death of a judge, justifies the grant of certiorari to review the judgment below.

VII. CONCLUSION

Wherefore, TIME OIL Co., Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit in the above entitled case.

Respectfully submitted,

ARTHUR P. KEARNEY
Counsel for Petitioner

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In the Matter of CHARLES W. WOLVERTON, fdba WOLCO STATIONS and WOLVERTON OIL COMPANY, Bankrupt No. 78006 TIME OIL COMPANY, *Appellant,* v. CHARLES W. WOLVERTON, and WOLVERTON OIL COMPANY, *Appellees.*	No. 71-2273 OPINION [Filed, Jan. 3, 1974 .....Clerk, U.S. Court of Appeals]

On Appeal From the United States District Court for the Northern District of California

Before: HAMLIN, KOELSCH and ELY, *Circuit Judges*
HAMLIN, *Circuit Judge*

This bankruptcy appeal comes before us in an unusual posture. All of the bankrupt's creditors have been paid 100 cents on the dollar. A creditor, however, appeals from the denial by the United States District Court for the Northern District of California to review the referee in bankruptcy's decision denying its claim upon surplus monies remaining in the bankrupt's estate.[1]

1. The question for review was initially indirectly presented by the bankrupt's petition to release certain monies held in trust. The Referee in Bankruptcy ordered the monies released on February 5, 1971. Appellant Time Oil Company's Petition for Review from this order was denied by the district court on July 15, 1971, and this appeal was taken therefrom.

Thereafter, on September 11, 1972, the Referee entered an order sustaining the trustee's objection to appellant Time Oil Company's proof of claim for the sum of $45,308.08.

The issue herein presented, characterized by the district court as one of first impression, was succinctly summarized by the referee:

> "A preferential transfer is made to secure an antecedent debt. The transferee, being unable to return the property, pays its value to the trustee. Later, all allowed claims properly filed are paid. A surplus exists.
>
> "May a creditor receive from a bankruptcy estate not only the amount of his debt, but the value of the property the bankrupt has given him to secure the debt?"

The referee concluded that the creditor was limited to receiving from the bankrupt's estate only the amount of the debt. The district court agreed. We affirm.

FACTS

The bankrupt, appellee herein, doing business as Wolverton Oil Company and Wolco Stations, operated a retail gasoline service station in Sunnyvale, Santa Clara County, California. On February 7, 1964, he was indebted to his supplier, Time Oil Company (Time), appellant herein, for the purchase of petroleum products in the amount of $22,560.33. On that date, the bankrupt assigned and transferred to Time, as security for said indebtedness and consideration for future consignments of gasoline, the following: (1) the leasehold on the above noted Sunnyvale service station, said lease having two years remaining on its original term, plus two renewal options for five years each, (2) the sum of $3,600, which had been deposited with the lessor as prepaid rent, and (3) improvements

By agreement and stipulation of both parties, this appeal is deemed to include an appeal by appellant Time Oil Company from the Referee's order of September 11, 1972, without the necessity for appellant to petition the district court for review.

The relevant facts and issues are identical to both appeals.

which the bankrupt had constructed and installed upon the premises covered by the lease.

The value of the leasehold assigned and transferred, including the amount of the prepaid rent, but excluding the value of the improvements, as found by the referee, was the sum of $36,000.00.

In April, 1964, within four months after the assignment and transfer noted above, the bankrupt filed a voluntary Petition in Bankruptcy, and was adjudicated a bankrupt. Subsequent to April, 1964, Time used up the prepaid rent on the property which had been assigned to it to secure the debt owed by the bankrupt, and failed to exercise the option to renew the aforementioned lease. In late 1966, Time abandoned the property, returning to the landlord its rights, title and interest therein.

In April, 1966, the trustee brought a preference action against Time for recovery of the property assigned and transferred to it in February, 1964, or its value. After a trial held in July, 1968, the referee found that the assignment and transfer constituted a voidable preference as defined in section 60 of the Bankruptcy Act (hereinafter the Act), 11U.S.C. § 96.[2] The referee further found that Time had converted the assigned leasehold by failing to exercise the option to renew.

Upon the referee's finding of the voidable preference, it

2. "Section 60(a)(1), 11 U.S.C. § 96(a)(1), defines a 'preference' as (1) a transfer of any property of the debtor, (2) to or for the benefit of the creditor, (3) for or on account of an antecedent debt, (4) while the debtor is insolvent, (5) within four months of bankruptcy, (6) which enables the creditor to obtain a greater percentage of his debt than some other creditor of the same class. Section 60b [11 U.S.C. § 96(b)] permits the trustee to avoid a preference if the creditor had reasonable cause to believe that the debtor was insolvent at the time of the transfer." *DuBay v. Williams*, 417 F.2d 1277, 1286 (9 Cir. 1969).

became incumbent upon Time to return the object of that preference, the leasehold, to the bankrupt's estate. Section 60(b) of the Act, 11 U.S.C. § 96(b). However, Time could not return that which it had converted and, in lieu thereof, the referee ordered Time to pay into the bankrupt's estate the leasehold's value, plus interest, a total sum of $45,308.08. The referee has ascertained this exact value largely upon the basis of the value of the five-year renewal option periods.

In March, 1969, the referee entered a judgment awarding the $45,308.08 to the trustee, payable to him by Time.

A Petition for Review was filed by Time from this judgment. The United States District Court for the Northern District of California (Harris, J.) denied the petition, and also denied a concurrently filed Motion for Relief from said judgment under section 60(b) of the Federal Rules of Civil Procedure. No appeal was taken by appellant from these orders and they became final. Thereafter, the trustee duly recovered from Time the $45,308.08 in payment of the judgment entered by the referee.

Acting for himself, and prior to the issuance of the preference order and judgment, the bankrupt had secured a new lease on the very property it had previously assigned and transferred to Time. The bankrupt took possession of the property in January, 1967, under a new five-year lease, with a five-year renewal option. Apparently, the operation of the service station under this new lease was profitable.

In the meantime, in March, 1965, the bankrupt had purchased from the trustee cause of actions for violations of the antitrust laws by the major oil companies. That sale, however, was consummated without notice to the

creditors. The United States District Court for the Northern District of California (Zirpoli, J.) therefore set aside the order confirming said sale, and this court affirmed. *Wolverton v. Shell Oil Company*, 442 F.2d 666 (9 Cir. 1971).[3] The result was to cast into the bankrupt's estate in excess of $150,000 in settlement proceeds. These funds created a substantial surplus in the bankruptcy estate.

In November, 1971, the referee entered his order directing the trustees to pay in full all properly filed claims, and to distribute a notice of additional time in which to file claims not previously filed.

Time then filed a claim for $45,308.08, the amount of the preference judgment it had been ordered by the referee to pay to the trustee and refiled its claim of $22,560.33.[4]

The original indebtedness owed by the bankrupt to Time, $22,560.33, was paid in full. But the referee, sustaining the trustee's objection, held that Time's sole legitimate claim was limited to this amount *i.e.*, the amount owed before the preferential transfer, and that Time was not entitled to recover both the amount of said debt and the value of the property given by the bankrupt to secure this indebtedness.

The issue for review is properly before us on appeal.[5]

---

3. In affirming Judge Zirpoli's order setting aside the sale from the trustee to the bankrupt, we stated:

> "• • • a sale to the bankrupt, especially when it is of an asset such as a cause of action of unknown but potentially great value, as here, offers opportunity for skulduggery that make it suspect. • • • Such a sale, when conducted with the total informality that appears here, ought not to stand." 442 F.2d at 669.

4. Reference is made to *Wolverton v. Shell Oil Company*, 442 F.2d 666 (9 Cir. 1971), for further details.

5. *See* note 1, *supra*.

DISCUSSION

Consideration of Time's arguments for reversal is prefaced by our identifying and separating the three aforementioned orders resulting in review.

We first noted the order and judgment in the preference action against Time, in favor of the Trustee in Bankruptcy (hereinafter preference order). The referee, after a trial, concluded that Time had converted the security it received for the indebtedness (the service station leasehold), and ordered Time to reimburse the bankrupt estate at the value thereof ascertained by the referee. Judge Harris affirmed this order, and Time took no appeal therefrom. The order is therefore final.

We also noted the order holding that Time had no interest in the excess estate monies beyond the sum of the indebtedness owed by the bankrupt. That order was also affirmed by Judge Harris, and is the subject of this appeal.

The other order, confirming the antitrust sale, reversed by Judge Zirpoli who was in turn affirmed by this court in *Wolverton v. Shell Oil Company, supra,* is of mere historical significance here.

Because Time did not appeal the preference order, we must accept it as face value. That order set aside a preference pursuant to section 60 (b) of the Act. The preference consisted not of a payment, but rather of security. This is a distinction without a difference, however, because a transfer set aside pursuant to section 60(b) of the Act includes the creation of a security interest. Section 1(30) of the Act, 11 U.S.C. § 1(30).

Explicit in the preference order is the finding that the secured property could not be recovered, inasmuch as it

consisted of a leasehold which the referee found Time had converted, Section 60(b) of the Act specifically provides that, if the secured property has been converted, the trustee is entitled "[to] recover * * *its value * * *." *See California Mercury Record Distributors, Inc. v. Phelps,* 283 F.2d 261 (9 Cir. 1960). Accordingly, the referee ascertained the value of the leasehold, plus interest, a total sum of $45,308.08. His judgment in favor of the trustee and against Time for that sum was consistent with the relevant Bankruptcy Act provisions.

Time, having disgorged its preference by payment of the above noted figure, was then in a position to recover the outstanding debt owed to it by the bankrupt, the sum of $22,560.33. *See* section 57(g) of the Act, 11 U.S.C. § 93(g); *Katchen v. Landy,* 382 U.S. 323, 330 (1966).

Time's contention that it is entitled to not only the amount of the debt owed prior to the preferential transfer, but also to the value of the converted property received from the bankrupt as security for said debt is predicated entirely upon equitable considerations.

Working from the premise that there now exists a substantial surplus in the bankruptcy estate, Time contends that to permit the bankrupt to retain the $45,308.08 it recovered for Time's conversion of the service station leasehold, when the bankrupt has independently acquired a new lease on those very same premises, would result in an inequitable windfall for the latter.

Collier states that "(t)he whole purpose of the bankruptcy system is to make the bankrupt's property available to his creditor and to give back any surplus to him." 3A Collier on Bankruptcy ¶ 66.03 at 2327, n.8 (14th ed. 1971).

Accordingly, the case law indicates the general rule to be that surplus monies held by the trustee pass and return to the bankrupt after payment of all properly filed claims and costs of administration. *See, e.g., Hendrie v. Lowmaster,* 152 F.2d 83, 85 (6 Cir. 1945); *Wheeling Structural Steel Co. v. Moss,* 62 F.2d 37, 40 (4 Cir. 1932); *Berl v. Crutcher,* 60 F.2d 440, 444 (5 Cir. 1932), *cert. denied* 287 U.S. 670 (1933); *In re Silk,* 55 F.2d 917, 918 (2 Cir. 1932); *Johnson v. Norris,* 190 F. 459, 462 (5 Cir. 1911), *cert. denied* 232 U.S. 723 (1914). *See generally,* 6 Remington, Bankruptcy Law, § 2890 (5th ed. 1952).

We recognize, of course, that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." *Local Loan Co. v. Hunt,* 292 U.S. 234, 240 (1934). *See also Pepper v. Litton,* 308 U.S. 295, 304 (1939). *See generally* 1 Collier, *supra,* at § 2.09. Indeed, the above noted general rule regarding distribution of surplus estate funds is based on just such principles of equity. *See,* 6 Remington, *supra.* Hence, there exists a corollary to that rule which recognizes that exceptional considerations of equity may dictate that surplusage pass to one other than the bankrupt. *E.g., In re Lenox,* 2 F.2d 926 (W.D. Pa. 1924).[6] *See In re Goss,* 43 F.2d 746 (W.D. Ga. 1930).

Time stands before this court having obtained a preference of the bankrupt's leasehold interest while having reasonable cause to believe that the bankrupt was insolvent. This leasehold interest has been found by the referee to be worth $45,308.08, including interest. Time converted this

6. *But see Burton Coal Co. v. Franklin Coal Co.,* 67 F.2d 796, 799 (8 Cir. 1933).

property and was ordered to return its value to the bankrupt's estate.

Time's standing as a converter is the product of a final order which may not now be collaterally attacked. *See Angel v. Bullington*, 330 U.S. 183 (1947). Neither can the referee's assessment of the converted property's value be herein challenged. *Id.*[7]

There exists an equitable doctrine which states that " 'he who comes into equity must come with clean hands.' " *Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co.*, 324 U.S. 806, 814 (1945). *See also, Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240, 244-45 (1933). It would be anomalous for this court to invoke equitable principles to allow a converter of security to recover payments for losses attributable to his own actions.

"The issuance of equity relief is a matter of discretion." *Berman v. Narragansett Racing Association*, 48 F.R.D. 333, 336 (D.R.I. 1969). *Precision Instrument Mfg. Co., supra*, 324 U.S. at 815. The scope of our review is accordingly limited to a determination of whether there was an abuse of said discretion by either the referee or the district court. *Delno v. Market St. Ry. Co.*, 124 F.2d 965, 967 (9 Cir. 1942); *Borchard v. California Bank*, 107 F.2d. 96, 98 (9 Cir. 1940); *rev'd on other grounds*, 310 U.S. 311 (1940). *See Lemon v. Kurtzman*, 411 U.S. 192, 200 (1973) (Burger, C.J.). *Cf. PPG Industries, Inc. v. Continental Oil Co.*, 478 F.2d 674, 682 (5 Cir. 1973); *Broadview Chemical Corp. v.*

7. Counsel responsible for prosecution of this appeal did not represent appellant during pendency of the "preference" litigation. At oral argument, he was unable to explain Time's failure to take an appeal from the preference order and judgment.

Loctite Corp., 417 F.2d 998, 1000 (2 Cir. 1969), *cert. denied*, 397 U.S. 1064 (1970). On the facts of this case, we are unable to so conclude.

Therefore, the district court's order denying appellant's Petition for Review, and the referee's order sustaining the trustee's objection to appellant's proof of claim, must both be affirmed.

In the Matter of

CHARLES W. WOLVERTON, fdba
WOLCO STATIONS and
WOLVERTON OIL COMPANY,
Bankrupt No. 78006;

TIME OIL COMPANY,
Appellant,

v.

CHARLES W. WOLVERTON
and WOLVERTON OIL COMPANY,
Appellees.

No. 71-2273

KOELSCH, Circuit Judge, dissenting:

This court pays lip service to the undoubted proposition that courts of bankruptcy are essentially courts of equity, and after doing so, applies dry legal principles to selected facts and summarily proceeds to decision.[8] Such treatment effectively "pulls the curtain" upon much that in conscience would and should be considered in arriving at an equitable conclusion; as a result, Wolverton, the erstwhile bankrupt, is allowed to both eat his cake and have it too.

As I read the opinion, the sole basis for the court's conclusion is that Time was a "converter" of Wolverton's property.[9] We are told that "[i]t would be anomalous for this

8. As succinctly said by the Fifth Circuit in *Johnson v. Norris*, a case cited by this court in its opinion, "A court of bankruptcy is a court of equity seeking to administer the law according to its spirit and not merely by its letter."

9. The conversion occurred when Time failed to renew the lease which Wolverton had assigned to Time as security and allowed the property to revert to the lessor.

The purpose of the reminder that "Time stands before this court having obtained a preference of the bankrupt's leasehold interest while having reasonable cause to believe that the bankrupt was insolvent" is not

court to allow a converter of security to recover payments for losses attributable to his own actions." However true that pronouncement might be in a dispute governed by legal principles, it should not be given currency in one tested by considerations of fairness. Wolverton has suffered no losses. To the contrary, he was able to, and in fact did, regain possession of the same property which he now has under a new lease on better terms than the old one. Moreover, by securing the new lease, Wolverton effectively foreclosed Time from recovering the property itself and being able to turn it back to Wolverton.[10]

Time has compensated Wolverton's trustee for the value of the property it converted. Wolverton now enjoys that property and is not "out of pocket"; indeed, he has profited as a consequence of the conversion. Time is entitled to a return of its money. I would reverse and remand with appropriate directions.

s/ signature
United States Circuit Judge

clear to me. The dispute here, of course, is not between the trustee and Time but between Time and Wolverton. The fact that Time was the recipient of a preferential transfer (from Wolverton) should not serve to put Time in a "bad light." There does exist a tendency to lose sight of the fundamental differences that exist between preferential and fraudulent transfers and indiscriminately to regard the recipients of both types of transfers as cheats or worse: ". . . the underlying theories of preferences and fraudulent conveyances are occasionally forgotten and the transactions so prohibited are accordingly confused. . . . There are however, certain clear distinctions between the two types of prohibited transactions which should be borne in mind constantly. First of all, it must be remembered that aside from legislative restrictions . . . a preference may be a perfectly valid and legitimate business transaction. On the other hand a fraudulent conveyance or transfer aside from statutory interdiction, is almost always invalid. There is no element of moral turpitude connected with the giving (or receipt) of a mere preference; . . . ." 3 Collier on Bankruptcy (14 ed.), Sec. 60.03, p. 763-4.

10. In this regard, attention should also be directed, if equitable treatment is to be granted Time, to the strange sequence of events ensuing

Wolverton's transfer of the property to Time. Section 60(b) of the Act provides that the trustee may recover the property, or, if it has been converted, its value." The alternative is not available absent a conversion. After Wolverton went into voluntary bankruptcy, Wolverton's trustee made no effort to reclaim the property while it remained in Time's possession. Had he done so, then, of course, he would have lost it to the lessor; for, as the referee found, "at no time prior to the expiration of the initial term of the Sunnyvale lease was there sufficient cash to perform the conditions and obligations of the lease."

Instead, the trustee waited until the "conversion" occurred and then engaged the bankrupt's personal attorney as special counsel for the purpose of conducting the preference action. The question arises as to the bona fides of the arrangement, for, as the Supreme Court noted in *Pepper v. Litton*, 308 U.S. 295, 299, n.4 (1939):

> "On the professional ethics of the conduct of Quillen, the District Court aptly observed: 'It is generally accepted that an attorney for the bankrupt should not be chosen attorney for the trustee in any case.'"

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In the Matter of CHARLES W. WOLVERTON, fdba WOLCO STATIONS and WOLVERTON OIL COMPANY, Bankrupt No. 78006 TIME OIL COMPANY, *Appellant,* v. CHARLES W. WOLVERTON, and WOLVERTON OIL COMPANY, *Appellees.*	No. 71-2273 ORDER DC No. Bkcy 78006 (GBH) [Filed March 12, 1974 .....Clerk, U.S. Court of Appeals]

Before: KOELSCH, DUNIWAY, and ELY, Circuit Judges.

After the issuance of the court's Opinion in the subject case and before the petition for rehearing and suggestion for en banc rehearing had been considered, Judge Oliver D. Hamlin, Jr. passed away. Thereafter, Judge Ben. C. Duniway was chosen, by lot, to act with Judges Koelsch and Ely in connection with the petition for rehearing and the suggestion for en banc rehearing. Oral argument in support of the petition was not heard. Rule 40(a) Fed. R. App. P.

Judges Duniway and Ely voted to deny the petition for rehearing and reject the suggestion for en banc rehearing. Judge Koelsch voted to grant panel rehearing but voted with Judges Duniway and Ely to reject the suggestion for en banc rehearing.

The full court has been advised of the suggestion for an en banc hearing, and no judge of the court has requested a vote on the suggestion for rehearing en banc. 35(b) Fed. R. App. P.

The petition for rehearing is denied and the suggestion for a rehearing en banc is rejected.

s/ WALTER ELY

United State Circuit Judges

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In the Matter of CHARLES W. WOLVERTON, dba WOLCO STATIONS and WOLVERTON OIL CO., *Bankrupt-Appellee,* v. TIME OIL COMPANY, *Appellant*	No. 71-2273 [Filed April 3, 1974 .....Clerk, U.S. Court of Appeals]

ORDER STAYING ISSUANCE OF MANDATE

Upon application of Bernard Petrie counsel for the appellant, and good cause appearing, IT IS ORDERED that the issuance, under Rule 41(a) of the Federal Rules of Appellate Procedure, of the certified copy of the judgment of this Court in the above cause be and hereby is stayed pending the filing, consideration and disposition by the Supreme Court of the United States of a petition for writ of certiorari to be made by the appellant herein, provided such petition is filed in the Clerk's Office of the Supreme Court of the United States on or before April 25, 1974.

In the event the petition for writ of certiorari is granted, then this stay is to continue pending the final disposition of the case by the Supreme Court of the United States.

s/ signature

United States Circuit Judge